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Nos. 83-908 and 83-909

In the Supreme Court of the United States

OCTOBER TERM, 1983

HARRY S. STONEHILL, PETITIONER

v.

UNITED STATES OF AMERICA

ROBERT P. BROOKS, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D. C. 20530
(202) 633-2217

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Petitioners challenge the court of appeals' affirmance of the district court's holding that they had failed to carry their burden of proving the government's tax assessments erroneous. The decision below is correct, does not conflict with that of any other circuit, and does not warrant review by this Court.

1. Petitioners Stonehill and Brooks[1] are United States citizens who resided in the Philippines during the tax years at issue. Petitioners had interests in numerous business ventures, chiefly involving tobacco, in the Philippines and elsewhere. Those ventures and the massive flows of funds they generated brought petitioners to the attention of Philippine and United States authorities (Pet. App. 2-4). In 1962, the Philippine National Bureau of Investigation raided the offices of petitioners and 17 of their corporations, seizing 35 truckloads of documents (*id.* at 4). Philippine authorities subsequently permitted representatives of the Internal Revenue Service (IRS) to examine these records, and the IRS ultimately copied 35,000 items.

A three-year worldwide audit ensued in which some 50 I.R.S. agents attempted to reconstruct petitioners' transactions with businesses in the United States, the Philippines, Hong Kong, Australia, Japan, Canada, France, England, Germany, Belgium, Luxembourg and Switzerland (Pet. App. 5, 36). These investigations revealed that, between 1958 and 1961, millions of dollars from various Philippine business dealings passed through petitioners' hands, much of it from illegal and unrecorded sources (*id.* at 3). Petitioners extracted "commissions" and rebates from exporters of American tobacco and received kickbacks from the Philippine manufacturers who purchased it (*ibid.*). They siphoned large sums of money from their Philippine controlled corporations and diverted it to Swiss banks, largely in an effort to evade Philippine currency restrictions (*id.* at 3 & n.3). More than $9 million — $4 million of which petitioners ultimately caused to be invested in U.S. securities

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[1]Although petitioners have filed separate petitions, their petitions are substantially identical except for one issue (see page 7, *infra*) raised by Brooks alone. For convenience, all citations herein will be made to Brooks' petition (No. 83-909) and the appendix thereto.

and real estate — flowed through black market channels to secret Swiss bank accounts and shell companies (*id.* at 3, 63-64). For these same years, petitioners reported combined incomes for U.S. tax purposes of about $200,000 (*id.* at 3-4).

Because the records of petitioners and their corporations did not accurately reflect income for 1958-1961, the Commissioner, using information uncovered by the audit, reconstructed petitioners' income by calculating increases in their net worth (Pet. App. 5). Based on these calculations, the Commissioner asserted deficiencies, including interest and fraud penalties, in the amounts of $13,613,722 against Stonehill and $11,182,967 against Brooks (*ibid.*). Fearing that collection of these taxes would be "jeopardized by delay," the Commissioner in 1965 issued jeopardy assessments against petitioners under Section 6861(a) of the Code.[2] The filing of the jeopardy assessments created tax liens against petitioners' property. I.R.C. § 6321. The government instituted this action to foreclose those liens on property belonging to petitioners in Hawaii and California (Pet. App. 5-6).[3]

A decade of litigation ensued, involving hundreds of depositions, dozens of hearings, and three successive federal judges (Pet. App. 6). Resolution was complicated by the absence of documents and witnesses, including petitioners, who appeared neither for scheduled depositions nor for trial (*id.* at 27). After pre-trial hearings in 1974, the government conceded that only half of petitioners' income was

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[2]Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended ("the Code" or "I.R.C.").

[3]The government filed suits in the United States District Courts for the District of Hawaii and for the Northern and Central Districts of California. The parties agreed that the judgment of the latter court would be entered as the judgment in the other actions. Pet. App. 6 n.8.

taxable by the United States, the other half being deemed under Philippine community property law to be the income of their Philippine wives, who (as aliens) were not subject to U.S. tax (*id.* at 6-7).[4]

A four-day bench trial took place in 1975. Because of the tremendous complexity of the case, the government sought to establish the asserted tax deficiencies by introducing only the jeopardy assessments themselves, electing to rely on the assessments' presumption of correctness rather than to prove each item of the underlying net worth calculations (Pet. App. 7). The government introduced testimony, exhibits and 40 volumes of documents to support the fraud penalties asserted by the Commissioner, as well as to rebut petitioners' attacks on various aspects of the net worth computations (Pet. App. 7, 10-11, 54 n.10).

The district court granted judgment in favor of the government (Pet. App. 35-74). It believed that the Commissioner's tax assessments should be adjusted downward in two respects: first, to reflect the government's concession that petitioners' wives had a community interest in half their income (*id.* at 55); and second, to reflect the court's finding that a 10 million peso bribe, paid by petitioners to Philippine officials in 1957, was a business rather than a personal expense, and was thus properly reflected in petitioners' opening net worth (*id.* at 59-61).[5] The district court rejected

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[4]Petitioners' wives have filed a separate petition for a writ of certiorari challenging the decision below insofar as it holds certain conjugal property subject to the government's tax liens. *Lourdes Blanco Stonehill and Pacita C. Brooks* v. *United States*, petition for cert. pending, No. 83-897.

[5]Since reconstruction of a taxpayer's income under the "net worth" method is basically accomplished by subtracting his opening from his closing net worth, the effect of increasing petitioners' opening net worth was to decrease their deemed income and thus to lower the tax assessments.

petitioners' other attacks on the IRS's methodology (*id.* at 56-59, 61-68) and held that "the Commissioner's determinations of tax deficiencies, as modified [in the two respects mentioned above, were] * * * correct and not arbitrary" (*id.* at 69). The court likewise sustained the fraud penalties (*id.* at 69-72).

The court of appeals unanimously affirmed (Pet. App. 1-32). It noted (*id.* at 9) the well-settled rule that the Commissioner's assessment of tax, if supported by a minimal evidentiary foundation, is entitled to a presumption of correctness sufficient to establish the government's prima facie case. *United States* v. *Janis*, 428 U.S. 433, 440-441 (1976); *Welch* v. *Helvering*, 290 U.S. 111 (1933). The necessary evidentiary foundation, the court continued, is laid "once some substantive evidence is introduced demonstrating that the taxpayer received unreported income" (Pet. App. 9), a showing that the court found the Commissioner to have made here given the "overwhelming evidence * * * that [petitioners] had received millions of dollars of unreported income from their Philippine and American businesses" (*id.* at 10).

The court of appeals likewise agreed with the district court that petitioners had failed to rebut the presumption by proving the Commissioner's assessments "arbitrary and erroneous." *Janis*, 428 U.S. at 442; *Helvering* v. *Taylor*, 293 U.S. 507, 515 (1935). The district court, it noted, had found that the two errors in the Commissioner's original assessments — respecting the community income and the 10 million peso bribe — were understandable in light of the legal and factual context, and that neither error betokened a "pattern of arbitrariness" that could operate to "taint the entire assessment" (Pet. App. 12-13, 14). The court of appeals concluded that this factual determination was not clearly erroneous (*id.* at 13).

2. Petitioners challenge the decision below on essentially two grounds. First, they reiterate their contention that the tax liens were based on "naked assessments" without "*any* evidence to support [them]," and hence were not entitled to the usual presumption of correctness (Pet. 15-16, 19, 24) (emphasis in original). As the court of appeals held (Pet. App. 10), however, there was overwhelming evidence that petitioners during 1958-1961 had received huge amounts of unreported income. This evidence, under settled law, sufficed to establish the prima facie validity of the assessments, and shifted to petitioners the burden of rebutting the presumption running in the assessments' favor. Contrary to petitioners' contention (Pet. 17-20), it is immaterial that the government placed in evidence neither the notices of deficiency nor the detailed net worth computations themselves, since it was petitioners' burden to show that the (presumptively correct) assessments lacked a factual foundation, not the government's burden to show the reverse. *Janis*, 428 U.S. at 442. Nor is there any merit to the suggestion (Pet. 20) that the failure to introduce these items unfairly deprived petitioners of an opportunity to challenge the assessments. As the court of appeals noted (Pet. App. 14, 18), petitioners received copies of the net worth calculations (which were attached to their notices of deficiency), deposed an IRS agent concerning them, repeatedly referred to them at trial, and specifically attacked many of the calculations' constituent elements.

Second, petitioners contend that, even if the assessments were entitled to a presumption of correctness, they carried their burden of rebutting that presumption. As the court below noted (Pet. App. 13), however, petitioners succeeded in convincing the trial judge of only two errors in the original assessments — the allocation of a share of community income to petitioners' wives, and the reflection of the 10 million peso bribe in their opening net worth. The

community property issue "presented a difficult question of Philippine law" on which "[e]xperts differed," and petitioners themselves "failed to make community property claims on their [U.S. tax] returns" (Pet. App. 15). The Commissioner's original characterization of the bribe, moreover, while ultimately rejected, was thoroughly reasonable: the payment was illegal, was not reflected on the corporate books, was apparently made with personal funds, and did not come to light until the time of trial (*id.* at 2, 15-16). The court of appeals thus properly concluded that neither error displayed the sort of arbitrariness or carelessness that could serve to taint the assessments as a whole. In any event, this factual determination does not merit this Court's review.

3. Petitioner Brooks contends (Pet. 15-19) that the assessment against him was based in part on secret grand jury testimony given by petitioner Stonehill, and that the IRS's use of this testimony violated the standards set forth by this Court in *United States* v. *Sells Engineering, Inc.*, No. 81-1032, and *United States* v. *Baggott*, No. 81-1938. This contention was raised in neither court below and must be deemed waived. In any event, nothing in the transcript of Stonehill's testimony that was admitted into evidence relates to Brooks' tax liability or to his potentially taxable income. Rather, the sole reference to Brooks in that transcript (Gov't Exh. 3, at 18) is a statement by Stonehill that Brooks was his business associate, an obvious fact familiar to anyone involved in the case. Even if one assumes that the grand jury transcript was improperly delivered to the IRS, therefore, it could not conceivably have furthered the government's case against Brooks, and accordingly could not operate to invalidate the tax assessments against him.

It is therefore respectfully submitted that the petitions for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

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